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No. 395

In the Supreme Court of the United States

OCTOBER TERM, 1957

UNITED STATES OF AMERICA, PETITIONER

v.

MOLLY G. BESS

ETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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CITATIONS

Case:

Stern v. *Commissioner*, 242 F. 2d 322, petition for certiorari pending, No. 311, this Term 4, 5

Statutes:

Internal Revenue Code of 1939:

Sec. 311 (26 U. S. C. 1952 ed., Sec. 311) 2, 14

Sec. 3670 (26 U. S. C. 1952 ed., Sec. 3670) 2, 4, 14

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The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the District Court (R. 11a–17a)[1] is reported at 134 F. Supp. 467. The opinion of the Courts of Appeals (Appendix A, *infra*, pp. 6–13) is reported at 243 F. 2d 675.

JURISDICTION

The judgment of the Court of Appeals was entered on March 28, 1957. (Appendix A, *infra*, p. 13.) On June 21, 1957, by order of Mr. Justice Brennan, the

[1] Record references are to the appendix of the Court of Appeals brief for Molly G. Bess, appellant in that court.

time for petitioning for a writ of certiorari was extended to August 23, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Decedent, Herman Bess, was indebted to the Government for income taxes. He had various life insurance policies as to which he retained, during his life, the right to draw cash surrender values and the right to change the beneficiary. He died leaving an insolvent estate. Respondent, his widow, is the designated beneficiary under the policies. The question is whether respondent is liable as transferee to the full extent of the net proceeds of the policies.

STATUTES INVOLVED

The pertinent provisions of Sections 311 (a) and (f) and 3670 of the Internal Revenue Code of 1939 are set forth in Appendix B, *infra,* pp. 14–15.

STATEMENT

Herman Bess, husband of respondent Molly G. Bess, died insolvent on June 29, 1950. (R. 3a, 5a.)

Prior to Bess's death, the Commissioner had assessed against him (on July 30, 1948) a deficiency for the year 1945 in the total sum of $11,541, consisting of $10,119.31 additional income tax plus $1,421.69 interest thereon. On the same date, the Commissioner assessed a deficiency for the year 1946 of $3,789.32, consisting of $3,507.03 additional tax and $282.29 interest. On August 24, 1950, the Commissioner assessed against Bess's estate for the year 1947 a deficiency of $925.94, composed of $813.22 additional income tax

and $112.72 interest thereon. In each case, notice and demand were made on decedent or his estate. Bess made partial payment of these deficiencies prior to his death, and his executrix made some payments after his death, leaving a total of $8,874.57 still unpaid. (R. 3a–4a.)

At the time of his death, Herman Bess carried eight insurance policies on his life with a total cash surrender value of $3,362.53 (R. 7a–10a), and total proceeds of $63,576.95. Molly G. Bess was the beneficiary of these policies. (R. 7a.) On all of the policies, Herman Bess had paid the premiums (R. 10a) and had retained the right to change the beneficiary (R. 7a–10a). With the exception of No. 8, a group insurance policy in the face amount of $2,500, decedent had retained the right to borrow against the cash surrender values and to assign the policies. (R. 7a–10a.)

By reason of the death of Herman Bess, Molly G. Bess, as beneficiary of the policies, became entitled to be paid according to their terms and has in fact received a total sum of $69,576.95. (R. 10a.)

The District Court held that Molly G. Bess was liable for the delinquent taxes of Herman Bess as the transferee of the proceeds of his policies. (R. 11a–17a.) The Court of Appeals vacated the judgment of the District Court, holding that Molly G. Bess was the transferee of the cash surrender values of the policies, which were property of Herman Bess prior to his death, but that she was not the transferee of the full proceeds of the policies, which were not the property of Herman Bess during his lifetime. The Court of Appeals held further that Molly G. Bess's

liability as the transferee of the cash surrender values was imposed by federal law and was not subject to state law limitations.[2] (Appendix A, *infra*, pp. 6–13.)

REASONS FOR GRANTING THE WRIT

Stern v. *Commissioner*, 242 F. 2d 322 (C. A. 6), petition for certiorari pending, No. 311, this Term, similarly involves a beneficiary of the life insurance policies of a delinquent taxpayer. As here, the insured retained, during his lifetime, the right to change the beneficiary and to draw the cash surrender values; as here, he died leaving an insolvent estate. The Sixth Circuit held that the beneficiary was not a transferee either of the surrender values of the policies or the proceeds thereof. It ruled further that the liability of a transferee for taxes owed by the transferor is subject to limitations imposed by state law. On July 25, 1957, the Government petitioned for a writ of certiorari in the *Stern* case, requesting this Court to consider (1) the beneficiary's liability as a transferee of the cash surrender values and (2) the beneficiary's liability for the full proceeds. We pointed out in our petition that there was a conflict as to the first question (with the instant *Bess* case) and that the second question was a closely related and an important one.

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[2] The Government had argued also that, by reason of assessments against decedent prior to his death, a lien had attached to all of his property, and that this was a proceeding to enforce the lien. See Section 3670 of the 1939 Code, *infra*, pp. 14–15. The Court of Appeals ignored this contention in its opinion. If certiorari is granted, the Government reserves the right to assert this alternative basis of recovery.

In the instant case, the Third Circuit has sustained the Commissioner's position that cash surrender values are reachable in the hands of the beneficiary (*infra*, pp. 12–13). It has also ruled that the question of transferee liability is exclusively a federal one and that state law limitations are accordingly inapplicable (*infra*, pp. 7–11). However, the court below agreed with the Sixth Circuit that net proceeds, as distinguished from cash surrender values, are not reachable.

If this Court should undertake to review in the *Stern* case the second question there presented, *i. e.*, the question of liability for the full proceeds of the policies, we believe that it should also grant review in the instant case.[3] For a fuller statement of the reasons why we believe this issue is one meriting the consideration of this Court, we respectfully refer to our petition in No. 311.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted.

J. LEE RANKIN,
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AUGUST 1957.

[3] We are informed that respondent, Mrs. Bess, is filing a cross-petition challenging the Third Circuit's ruling that there was liability to the extent of the cash surrender values.

APPENDIX A

1. Opinion of the Court of Appeals

No. 12026

In the United States Court of Appeals For the Third Circuit

UNITED STATES OF AMERICA

v.

MOLLY G. BESS, APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Argued December 4, 1956

Before BIGGS, *Chief Judge*, KALODNER, *Circuit Judge*, and KRAFT, *District Judge*.

OPINION OF THE COURT

(Filed March 28, 1957)

By BIGGS, *Chief Judge*.

The court below gave judgment in favor of the United States against the defendant, Molly G. Bess, widow of Herman Bess, on the theory that under Section 311 of the 1939 Code, 26 USCA (I. R. C. 1939) § 311, the defendant was a transferee of property of a taxpayer, her husband, who owed the government delinquent income taxes.

The facts are not in dispute. The defendant's husband died on June 29, 1950. At the time of his death there were in force eight insurance policies on his life. Seven of the policies were issued during

1934, 1935, 1936, and 1937. The eighth, a group insurance policy with no cash value, was issued June 19, 1950. Herman Bess had the right to change the beneficiary of the policies and also had the right to borrow upon the security of the cash surrender value of the seven policies described first herein. The defendant was named as beneficiary when the policies were issued to Herman Bess, and, except for temporary changes with respect to two policies,[1] the defendant remained the beneficiary. The government and the defendant have assumed, without dispute, that Herman Bess was solvent when the policies were issued, and have stipulated that he was solvent when the premiums were paid. The total cash surrender or loan value of all the policies was $3,362.53 at the time of Bess's death. The defendant received $63,576.95 as the total proceeds of the eight policies.

On July 17, 1952, more than two years after his death, the estate of Herman Bess was adjudged insolvent. Part payment has been made on the claims of the United States for income taxes owed by Herman Bess, but a balance of $8,874.57 remains unpaid. The United States instituted suit against the defendant for that amount plus interest from the date of assessment and was awarded judgment in the sum of $11,657.30. 134 F. Supp. 467 (D. N. J. 1955). Mrs. Bess has appealed.

The statute on which the alleged liability of the defendant is bottomed is Section 311 of the 1939 Internal Revenue Code, 26 USCA (I. R. C. 1939) § 311,

[1] In one policy the beneficiary was changed from the defendant to the insured's estate on April 4, 1945, and on the same day the defendant was redesignated as the beneficiary; in another policy the beneficiary was changed from the defendant to the insured's estate on March 23, 1945, and on April 3, 1945 the defendant was redesignated as the beneficiary.

set out in the margin.[2] It is the universal view that the statute created no new substantive rights and liabilities and that the only liabilities to be enforced thereunder are those existing in law or in equity when the enforcement proceeding is begun. *Pearlman v. Commissioner,* 153 F. 2d 560, 561–2 (3 Cir. 1946), and *Rowen v. Commissioner,* 215 F. 2d 641, 643 (2 Cir. 1954). Herman Bess was domiciled in New Jersey up to his death. His widow's domicil remains there. In *Pearlman v. Commissioner, supra,* at p. 562, we stated that "On principle the question [as to the existence or non-existence of liability on the part of the widow] seems to us clearly to be one to be answered without reference to state law limitations." We also said, since we had before us a husband domiciled in Pennsylvania until his death with his wife's domicil remaining there, that "Whether the reliance is placed on general law as declared by federal courts, or on Pennsylvania law, we think the conclusion of the Tax Court must stand." We may

[2] Section 311 provides in pertinent part: "Transferred assets—(a) Method of collection. The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

"(1) Transferees. The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

* * * * * *

"(f) Definition of 'transferee'. As used in this section, the term 'transferee' includes heir, legatee, devisee, and distributee."

perhaps remark here, without cynicism, that a declaration on principle is not necessarily a declaration of law, but we went on to say that we preferred to rest the decision on the wider ground that since there was a federal tax question to be decided it should be decided on general law as laid down by the Federal courts and not be subject to the limitation in the law of any State. We adhere to our former ruling but since this case may reach the reviewing Court, other Courts of Appeals having reached the contrary conclusion, *Rowen* v. *Commissioner, supra,* and the authorities cited therein, 215 F. 2d at 648–9, we have set out what we believe to be the status of Mrs. Bess under the law of New Jersey, were that law applicable, in *footnote 3 below.* Cf. *Poe* v. *Seaborn,* 282

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[3] As to the law of New Jersey the applicable sections are New Jersey R. S. 17:34–28 and 17:34–29; NJSA 17:34–28 and NJSA 17:34–29. Section 29 provides that every policy of life insurance made payable to or issued for the benefit of a married woman, or after its issue assigned or in any way made payable to a married woman, whether by her husband or by any other person, shall "inure to her separate use and benefit * * *" according to its terms unless premiums were paid in fraud of creditors as set out in Section 28. There can be no doubt that in the absence of fraud on creditors in the payment of premiums or assignment of the beneficial interest to some person other than to the wife, the wife's interest in the proceeds of a policy has a status described by the law of New Jersey as a "vested interest" and may not be reached by a creditor, even by the United States. Cf. *Sullivan* v. *Maroney,* 76 N. J. Eq. 104, 109, 73 A. 843, 844 (1909), affirmed 77 N. J. Eq. 565, 78 A. 150 (1910), and *Phoenix Mut. Life Ins. Co.* v. *Connelly,* 188 F. 2d 462, 464–5 (3 Cir. 1951).

As we have stated the parties have agreed that Herman Bess was solvent when the policies were issued and that he was solvent at all times when premiums were paid. There therefore was no payment of premiums in fraud of creditors and Mrs. Bess was designated as beneficiary at all times save for two small irrelevant periods in respect to only two of the

U. S. 101 (1930); and *United States* v. *Scott*, 167 F. 2d 301 (8 Cir. 1948).

As to the general law as declared by the Federal courts the decision of the Supreme Court in *Central Bank of Washington* v. *Hume*, 128 U. S. 195 (1888), is illustrative of features of it. The decision holds, *inter alia*, that it is the general rule that a policy and the money to become due under it, belong, the moment the policy is issued to the person named in it as the beneficiary. The policies of insurance in the *Hume* case quite possibly did not provide that the insured could change the beneficiary but this feature, as we have indicated, is irrelevant here. Hume was admittedly insolvent at the time that the insurance was effected and it was argued that the policies were within the provisions of 13 Elizabeth, c. 5. The Supreme Court was of the view that the statute of 13 Elizabeth governed and held *inter alia* that Hume's creditors were not entitled to recover the premiums paid by him on life insurance policies issued for the benefit of his wife and children. The statute of 13 Elizabeth was designed to prevent conveyances which defeated or delayed creditors. It declares, in substance, that every conveyance made to the end, purpose, and intent to delay, hinder, or defraud creditors and others of their just and lawful actions shall be void, with the proviso that nothing therein con-

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policies. See note 1, *supra*. As to the cash surrender value of the policies, amounting to $3,362.53, though we have found no case in point and none has been cited to us, we are of t opinion that the term "proceeds" as employed in the New Jersey statute means the full amount payable to the beneficiary upon the policy on the death of the insured. It follows therefore that under the law of New Jersey Mrs. Bess may retain the full proceeds of the policies in the instant case without liability for the claim asserted by the United States agafnst her husband for unpaid taxes.

tained shall extend to defeat any estate or interest made on good consideration and bona fide to any person having, at the time, no notice of such fraud. 24 Am. Jur., Fraudulent Conveyanace § 4, p. 163. See Annotation, 31 A. L. R. 51. The statute of 13 Elizabeth is generally acknowledged to be the principal source of judicial decision as to when a conveyance is fraudulent. *Id.* at p. 164. The statute is declaratory of the existing principles of the common law. *Ibid.* We believe that the governing principles of the general law are as set out in this paragraph.

Coming now to our decision in the *Pearlman* case we find that the court below interpreted our ruling as requiring it to decide that the proceeds of the policies in the case at bar were transferred to Mrs. Bess[4] on her husband's death. We think that such a conclusion was not warranted by our Pearlman decision[5] nor is it supported by more recent cases.[6] The proceeds of the policies—putting cash surrender values to one side for the time being—were not the property of Herman Bess as required by Section 311 (a) (1). He never possessed the right to receive the proceeds and therefore he could not transfer them. Moreover, as we have stated, Bess was solvent when the policies were issued and solvent at all times when premiums were

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[4] We conclude this because, while the proceeds of the policies amounted to $63,576.95, and the judgment in favor of the United States to $11,657.30, the amount of the judgment far exceeded the cash surrender value of the policies which, as we have stated in this opinion, was $3,362.53.

[5] The facts of the case as found by the Tax Court in 4 T. C. 34 (1944) disclose that the cash surrender values of the pertinent policies totaled $51,541 and that the tax liability was $25,713.57. See *Rowen* v. *Commissioner*, 215 F. 2d 641, 645. (2 Cir. 1954) on this point.

[6] See *United States* v. *New*, 217 F. 2d 166, 167 (7 Cir. 1954), and *Rowen* v. *Commissioner*, 215 F. 2d 641, 644 (2 Cir. 1954).

paid. In the *Pearlman* case, while Pearlman was solvent when the policies were issued and when some of the premiums were paid, after he became insolvent and up to the time of his death he continued to pay the premiums on the policies. In *Pearlman* we went no further than the Tax Court which held that the beneficiaries of the policies were transferees as to the cash surrender value of the policies. In the case at bar Mrs. Bess cannot be found to be a transferee of the *proceeds* of the policies under the general law as we have set it out.

The cash surrender values of the policies in the instant case present a different issue. Bess was adjudicated insolvent more than two years after his death but the account filed by Mrs. Bess as executrix makes it clear that he also was insolvent at the time of death. At the time of his death, as we have stated, the policies possessed a cash surrender or loan value of $3,362.53. He therefore possessed just prior to his death, a chose in action in the amount stated which he could have collected from the insurance companies in accordance with the terms of the policies. The Supreme Court in the *Hume* case, *supra,* seemed to recognize the payment of premiums as transfers and the incidence of the payments of premiums therefore timed the transfers here. By the terms of the policies in the *Hume* case nothing passed at the time of Hume's death. So was it here. It is therefore not realistic here, as the court pointed out in *Rowen* v. *Commissioner, supra,* 215 F. 2d at p. 647, in a like situation, to view Bess's death as wiping out the loan or surrender values. Bess's death was merely a condition on the occurrence of which the loan or surrender values of the policies no longer were payable to him but became merged in the larger values which the insurance companies were obligated to pay to Mrs.

Bess. The loan or surrender values were then an item of property and Mrs. Bess was a transferee of them within the meaning of Section 311 (a) (1). It follows that the United States is entitled to recover the amount of the loan or surrender values from her.

Other points raised by the parties do not require discussion.

The judgment of the court below will be vacated with the direction to enter judgment for the United States in conformity with this opinion.

2. Judgment of the Court of Appeals

[Caption omitted]

[Filed March 28, 1957]

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby vacated, with direction to enter judgment for the United States of America in conformity with the opinion of this Court.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(f) *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

(26 U. S. C. 1952 ed., Sec. 311.)

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, addi-

tional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 1952 ed., Sec. 3670.)

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